

UNITED STATES BANKRUPTCY COURT FOR THE
DISTRICT OF PUERTO RICO

In re:	:	
	:	Case No. 93-00130 (GAC)
TOMAS ESPADA ESPADA	:	Case No. 93-02203 (GAC)
LEONILDA OLAVARRIA HERNANDEZ	:	Consolidated
	:	
Debtors	:	Chapter 7
	:	

BACKGROUND

This case began on January 13, 1993, with the filing of a voluntary petition in Chapter 11. On December 9, 1993, the United States Trustee filed a motion to convert the case to Chapter 7 pursuant to 11 U.S.C. sec. 1112(b). The Trustee noted that the debtors were operating their business as debtors-in-possession and that monthly operating reports had not been filed. The Trustee indicated that the debtors had not filed a disclosure statement or a plan for reorganization. The Trustee also pointed out that the debtors had failed to produce documents requested by the U.S. Trustee, such as evidence of bank accounts, insurance for properties and amended schedules. The Trustee argued that the debtors were thwarting the efforts of the Trustee and that the delay by the debtors was unreasonable.

The debtors responded to the Trustee's motion for conversion on December 14, 1993, by requesting a voluntary dismissal. The debtors argued that they believed that they could sell some of their real property and pay off all of their creditors. The

debtors admitted that they had not faithfully complied with the guidelines established by the U.S. Trustee for the administration of a Chapter 11 case. The debtors further admitted that they had not complied with provisions of the Bankruptcy Code.

On December 16, 1993, at a hearing in open court, the debtors agreed that if they were unable to sell their real property within thirty days and pay their creditors, they would acquiesce to the Trustee's request for conversion to Chapter 7. On March 15, 1994, as the debtors had not sold the property, the case was ordered converted to Chapter 7. On March 16, a Chapter 7 panel trustee was appointed. In the Chapter 7, the most recent schedules filed by the debtors on October 6, 1994, indicate that the value of their real property is \$719,000. They valued all of their assets at \$784,800. Their total liabilities, reflected by their schedules, amount to \$2,122,073.

On July 29, one of the creditors filed a motion indicating that the debtors had admitted at a 341 meeting that they voluntarily constituted a \$75,000 mortgage on one of the real properties belonging to the estate. The debtors did this without approval from the bankruptcy court and without the prior knowledge of their creditors. The creditor requested that the debtors surrender the \$75,000 and that they be held in contempt for their actions. The debtor and the Chapter 7 trustee were ordered to respond. The debtor responded by requesting a

voluntary dismissal of the case on August 5, 1994. The trustee responded that he was seeking to obtain information as to the use or whereabouts of the \$75,000. The trustee indicated that the debtors had failed to appear at the 341 meeting that was continued for this express purpose. The trustee requested that the court issue an order compelling the debtors' appearance at the 341 meeting.

By order dated August 25, 1994, the bankruptcy court, Judge de Jesús presiding, granted the debtors' request for a voluntary dismissal, provided that there was no opposition filed within twenty days. Timely opposition was filed by the Chapter 7 trustee and by two of the creditors. The trustee argued that liquidation of the debtors' assets would better serve the creditors' interests and that the debtors' conduct, in constituting the \$75,000 mortgage and in failing to appear at the continued 341 meeting, did not make them worthy of a voluntary dismissal. The creditors argued that liquidation of the estate would better serve the creditors' interests. On September 30, 1994, one of the secured creditors filed a motion requesting dismissal. The issue of whether the case should be dismissed was set for hearing on December 15, 1994.

On October 6, 1994, the trustee filed a notice of intent to sell real property of the debtor at a public auction scheduled for October 27, 1994 at 11:00 a.m. On October 21, the debtors

filed a motion requesting that this court cancel the auction. In their motion, the debtors argued that the sale of two of the five properties, noticed for auction, would realize enough money to pay all valid claims of creditors. The debtors indicated that they wanted to retain their business. They requested the court to order the trustee to sell two of the five properties and to pay in full all of the valid claims. The motion indicated that if the funds were insufficient, the trustee could then sell the remainder of the real property. The debtors requested an emergency hearing to consider their motion.

On October 21, 1994, the debtors also filed an informative motion indicating that they had mortgaged a property of the estate in the amount of \$75,000 and had spent all of the money. The motion indicated that the debtors were not aware that permission was required from the court to mortgage property of the bankruptcy estate.

A hearing was held on October 24. No witnesses were called to testify. Arguments were made by the debtors' attorneys in favor of canceling the auction and by the Chapter 7 panel trustee and the United States Trustee in favor of allowing the auction to proceed. Counsel for one of the secured creditors appeared to argue in favor of dismissal of the Chapter 7 case.

At the hearing the debtors produced another motion that had been filed the same day. In this motion the debtors responded to

the opposition to the debtors' request for a voluntary dismissal. The debtors requested that the court grant their request to voluntarily dismiss the case or in the alternative that they be allowed to convert to Chapter 11.

DISCUSSION

In response to questioning by the court at the hearing, the debtors indicated that they were requesting a temporary restraining order. The Chapter 7 trustee and the United States Trustee argued that in order to receive this relief from the court, the debtors were required to comply with FRBP 7065, which indicates that Fed. R. Civ. P. 65 applies. Fed. R. Civ. P. 65(b) indicates that a temporary restraining order may not be issued without the filing of an affidavit or a verified complaint. The attorney seeking the temporary restraining order must also certify to the court in writing the efforts that have been made to give notice and the reasons supporting the claim that notice should not be required.

The debtors in this case have not submitted an affidavit or a verified complaint or a certification of efforts made to give notice and the reasons supporting the claim that notice should not be required. The debtors motion however, if treated as an objection to the notice of intent to sell the property is not procedurally deficient. The debtors are not required to file an adversary proceeding to object to the sale of property. FRBP

6004 governs sales of property. Objections to sale are allowed under FRBP 6004(b). This rule further indicates that an objection to the proposed sale is governed by FRBP 9014. In turn FRBP 9014 indicates that an objection to sale is treated as a contested matter.

The court will treat this as a contested matter. In a contested matter the objecting party is not required to file an affidavit or verify the papers filed. FRBP 9011(b). Accordingly, the court will address the merits of the relief requested by the debtors.

Preliminarily, the debtors argue that this case was dismissed pursuant to Judge de Jesús' order of August 25, 1994 and that opposition to the dismissal is in essence a request for reconsideration of the dismissal. The debtors thus indicate that their case is currently dismissed and that their real property can not be sold since they are not in bankruptcy.

The court finds that this argument does not have merit. Judge de Jesús' order of August 25 states that:

Wherefore, the request for voluntary dismissal is granted provided no opposition is filed within 20 days, by a party in interest. The Clerk will notify this order. Once it becomes final will enter judgment accordingly, close all proceedings and vacate any hearing date.

Documents in opposition to the debtors' request for voluntary dismissal were filed within the twenty days provided in Judge de Jesús' order. Accordingly a judgment of dismissal was never

entered. The proceedings were never closed. The hearing dates were not vacated. This case was not dismissed.

The debtors principle argument in opposition to the auction, is that the sale of only two of the five properties would pay all of the valid claims. When the Chapter 7 trustee and the United States Trustee presented the debtors' schedules, which show that the debtors are grossly insolvent, the debtors responded that their property was worth more than what the debtors' schedules reflected. The debtors presented an appraisal from May of 1992, which included the two properties that the debtors are agreeing to sell, but the debtors did not bring the person who supposedly conducted the appraisal to court to testify. The debtors also indicated that they only intended to pay **valid** claims and that they intended to object to the rest of the claims.

The court takes judicial notice of the debtors' schedules, which were filed this month and reflect that the debtors' liabilities are almost three times as much as the debtors' assets. With respect to the validity of the claims filed, the Bankruptcy Rules provide that "[a] proof of claim executed and filed in accordance with . . . [the Bankruptcy Rules] shall constitute prima facie evidence of the validity and amount of the claim." FRBP 3001(f). No objections to any of the claims have been filed nor has any party in interest introduced evidence questioning the validity of any of the claims. Accordingly, the

court finds that all of the claims filed are valid claims and that the sale of only two of the debtors' properties would not generate enough money to pay all claims.

The court also notes the arguments of the Chapter 7 trustee at the hearing, which were not refuted by the debtors. Essentially the Chapter 7 trustee argued that it would be difficult to sell only the two properties that the debtors want to sell at this time. The five properties are in two groups, with two of the properties connected to each other and the remaining three properties connected to each other. Within the two segments there is free access between the buildings. Accordingly, the segments would be difficult to divide and the properties are expected to sell as segments. The debtor proposes to sell one property from each segment. Given the composition of the segments, this appears impractical.

The debtors argue that the sale will be very detrimental to them since the properties will sell in an auction for less than market value. The Chapter 7 Trustee, however, indicated that \$9,500 had been expended by the auction company in preparation for the auction. Notice of the auction has been posted in magazines and in newspapers. A brochure has been prepared describing the properties and mailed to businesses nationwide that appear on the debtors' mailing list. The auction has also been noticed to all creditors. Accordingly, the court finds that

sufficient steps have been taken to try to get the best price possible for the debtors' property.

The debtors also contend that they have a right to reconvert to Chapter 11 and to reorganize or propose a plan of liquidation to sell their real property in a manner that is more conducive to achieving a fair price.

The United States Trustees' motion to convert the original Chapter 11 to Chapter 7 was made under 11 U.S.C. sec. 1112(b). Although the debtors originally objected to the motion, they subsequently acquiesced to the conversion because they were unable to sell their real property. Now the debtors request conversion back to Chapter 11 pursuant to 11 U.S.C. sec. 706(a) which indicates that "[t]he debtor may convert a case under this chapter to a case under chapter 11 . . . at any time, if the case has not been converted under section 1112" The legislative history of 11 U.S.C. sec. 706 also indicates that the debtor has a one-time absolute right of conversion of a liquidation case to a reorganization case, but "[i]f the case has already once been converted from chapter 11 or 13 to chapter 7, then the debtor does not have the right. (HR Rep No. 595, 95th Cong, 1st Sess 380 (1977); S Rep No. 989, 95th Cong, 2d Sess 94 (1978)).

The court finds that the original conversion from Chapter 11 to Chapter 7 was pursuant to section 1112 and accordingly the

debtor does not have the right to reconvert to Chapter 11. A conversion is still allowed, on request of a party in interest, only if the court in its discretion finds that such a conversion would be to the benefit of all parties in interest. 11 U.S.C. sec. 706(b); (HR Rep No. 595, 95th Cong, 1st Sess 380 (1977); S Rep No. 989, 95th Cong, 2d Sess 94 (1978)).

The court finds that the debtors had an opportunity both to attempt reorganization in Chapter 11 or to attempt to sell their property in Chapter 11. The debtors established a dismal track record. During the fourteen months when the debtors were previously in Chapter 11 they failed to file operating reports and other documents required by the United State Trustee to oversee the case. The debtors failed to file a disclosure statement or a plan. The debtors admitted that they had not complied with the bankruptcy code or the requests of the U.S. Trustee. The debtors proposed that they be allowed to find a buyer for their real property and sell the property to pay their debts. The debtors made this proposal to avoid the U.S. Trustee's proposed conversion to Chapter 7 pursuant to 11 U.S.C. sec. 1112(b). The court granted the debtors thirty days to attempt the sale. Three months later the court ordered the case converted because the debtors did not sell the property or take any other action in the bankruptcy case. Since the conversion to Chapter 7, the debtors have voluntarily incurred a \$75,000

mortgage on property of the estate without this court's permission or notice to parties in interest. The debtors have indicated that they no longer have any of the cash received from this mortgage. Further, the debtors have failed to appear at the continued 341 meetings in this case. This court finds that the debtors' history in Chapter 11 and in Chapter 7 suggests that the debtors would not act to the benefit of all parties in interest if they were allowed to reconvert to Chapter 11.

The debtors' track record suggests that the debtors have engaged in dilatory tactics and will take any action to delay the inevitable, which is the sale of the debtors' real property to pay their debts. The Chapter 7 trustee indicated that \$9,500 has been expended thus far in preparing for the auction. This is a substantial sum of money. Because the debtors are insolvent the costs of the auction are ultimately being borne by their creditors in that but for the expense of the auction, the full value of the property would be disbursed to creditors. Canceling the auction or rescheduling it would require the creditors to bear the expense of the auction twice. This is not warranted.

Finally, the debtors are not irreparably harmed by the sale of their property. If the property is sold for more than the debtors' liabilities, the debtors will recover the surplus. If the case is ultimately dismissed, after the hearing scheduled to consider the motions for dismissal, title to any property in the

estate would revert back to the debtors, subject to any existing liens.

ORDER

It is ordered that the debtors' objection to the sale of the five properties, scheduled for October 27, 1994, is overruled. The debtors' request for an emergency remedy and/or request for a temporary restraining order to cancel the auction is hereby denied. It is further ordered that the debtors' request to convert from Chapter 7 to Chapter 11 is denied.

IT IS SO ORDERED.

Dated at San Juan, Puerto Rico this ____ day of October, 1994.

Gerardo A. Carlo
U.S. Bankruptcy Judge